

Good MornING Asia - 16 January 2018

Weaker dollar is good for Asia as it helps Asian domestic economies, by allowing local central banks to keep local policy accommodative

In this bundle



Weaker dollar - good news for Asia

So long as this remains orderly, we believe that a weaker USD helps Asian domestic economies, by allowing local central banks to keep local policy...

By Robert Carnell



Indonesia

Indonesia: Current Account stress from weak December exports

Any downside growth surprise from exports in December would lead to a less favorable current account deficit expectation



Philippines

Philippines: November Remittances Disappoint

The Philippine peso's (PHP) bias for weakness is due to challenging external payments as November overseas worker remittances slow to 2% YoY



India

India – A mixed inflation bag

With the risk of worsening public finances overshadowing green shoots of economic recovery, the Indian rupee will remain under weakening pressure in 2018

Opinion | 15 January 2018

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Help where help is needed

There is nothing wrong with Asian exports - 2017 recorded some very strong growth. Admittedly, much of that was off a very weak base in 2016, and 2018 growth rates will look softer. Moreover, the electronics product cycle has helped propel some amazing strength in semiconductor sales, which we see morphing into stronger handset exports through 2018. Again, there is nothing wrong with Asian exports.

Asian domestic demand is not bad, but aside from the government supported construction and investment sectors, it could be a lot better. China may be the exception that proves this rule. So we are entirely relaxed to see the USD remaining soft, even as the prospects for the Fed this year seem to be firming around expectations for three more rate hikes. Prospects for a possible US

government shutdown by week-end may help keep the USD on the back foot through the rest of the week, though of course, expect a bounce if this situation is resolved.

Why is this good news for Asian domestic demand? In short, the USD's weakness by default translates into relative strength for Asia's currencies. It also by default tends to keep inflation subdued, as imported goods prices tend to be USD denominated, and therefore cheaper in local Asian currencies. This has meant that despite being a very dollar-centric region, there has been little tightening in the region, despite the Fed's slow and steady removal of accommodation. And it also means that even with expectations for more from the Fed this year, we expect to see Asian central banks lagging far behind in terms of their own normalisation. This is no bad thing for local domestic demand.

Of course, there is another side to the weak USD story, and that is a strong EUR. Yes, both economic giants are looking at very strong growth, and the US has the advantage of the recent tax reform bill to propel growth further in the coming quarters. But investors, rightly in my view, see the prospects for change in ECB policy, as the bigger and more market impactful change. ECB Governor Hanson suggested recently that if growth and inflation did not materially weaken by September this year, that QE in the Eurozone could end then. That sort of comment will kill any suggestion that the ECB will milk QE out as long as possible, with an extremely elongated taper.

The dollar's weakness is also not bad for the world's energy and other commodity exporters, for whom a weaker USD typically means higher USD commodity prices, and higher local currency receipts. We saw a marked dip in Asian exports following oil's soft patch in 2015, we think because it hit the terms of trade for the world's energy exporters, making Asian exports less affordable. A moderate, and stable oil price around USD60-70 is likely to provide a much more stable demand backdrop for Asia's exporters, even if higher oil prices are usually regarded by short-cut economists as a global tax hike.

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Indonesia: Current Account stress from weak December exports

Any downside growth surprise from exports in December would lead to a less favorable current account deficit expectation



Source: istock

6.9%

December export growth

disappointing export performance

Worse than expected

Downside growth surprise from exports

Any downside growth surprise from exports in December would lead to a less favorable current account deficit expectation. December import growth of 17.8% was roughly in line with the market forecast of 18.1%. Weak exports and relatively strong imports resulted to the second monthly deficit in 2017, at -\$271m in December, a reversal of the \$1.1bn surplus in December 2016. December exports were up 6.9% YoY, only half the market forecast. Non-oil exports were a major disappointment, posting only a 5.6% YoY increase, a third of the 11M average growth of 18% and below our forecast of 15%. Possibly slower demand and negative base effects resulted to the weakness. Import growth on the other hand resulted from 50% YoY growth in oil and gas imports

and a 13% YoY increase in non-oil imports. Non-oil import growth was slower than the 11M average growth of 15.6%.

Current account deficit for 4Q forecast likely to be larger than 4Q16

The 4Q17 current account deficit could reach \$4bn with a significantly lower trade surplus of just \$945m -30% of the trade surplus of \$3.1bn in 4Q16. We had earlier expected a current account deficit of only \$3bn on a trade surplus of \$2.2bn. The revised current account deficit forecast of \$4bn is equivalent to 1.7% of GDP. The full year 2017 current account deficit would likely amount to \$15.5bn or 1.5% of GDP. Bank Indonesia, Indonesia's central bank, expects the 2017 current account deficit to be below 2% of GDP. We expect export growth in 2018 to slightly outpace import growth, resulting in a trade surplus of \$14.5bn and a current account deficit of \$18bn or 1.6% of GDP.

Philippines: November Remittances Disappoint

The Philippine peso's (PHP) bias for weakness is due to challenging external payments as November overseas worker remittances slow to 2% YoY



Source: Shutterstock

Slower growth from major sources of remittances

November cash remittances slowed to 2% YoY from November 2016's growth of 18.5% and from October 2017's growth of 8.4%. The 11-month growth of total remittances is 4% which is in line with the central bank's forecast growth of 4% in 2017. Slower remittances were seen in most regions and major host economies. Remittances from Japan slowed to 2.8% YoY in November bringing 11-month growth to 7% from the 10-month average of 7.4%. Remittances from the US also slowed to 2.4% YoY, bringing the 11-month growth rate to 5.5%. The US remains the largest source of remittances with an 11-month share of 34% while Japan is responsible for 5.2%. Remittances from the Middle East, which accounts for 28% of total remittances, contracted by 6% YoY in November as remittances from Saudi Arabia slid 18.5% YoY. The country accounts for 10% of total remittances. The exceptions are Asian and European regions. Remittances from other Asian economies offset the slowdown from Japan and pushed regional remittance growth to 13% YoY in November to bring the 11-month growth rate to 6.2%. Remittances from Asia account for 19% of the total. Remittances from Europe increased by 6.2% YoY in November and brought the 11-month growth rate to 1.5% from only 1% for the 10-month period. Sustained recoveries in

these regions partially offset the slower US, Middle East and Japanese remittances. However, we expect a seasonal rise in December due to the Christmas holidays.

2% YoY

Worse than expected

November Remittances slow

Negative base effects only?

PHP weakness as remittances cannot finance the trade deficit

Overseas worker remittances of \$2.3bn is \$1.5bn short of fully financing the November trade deficit of \$3.8bn. The 11-month shortfall amounted to \$413m, a reversal of the \$107m surplus in the same 11-month period in 2016 and a major collapse from the 11-month surplus of \$12.6bn in 2015. Strong import growth reflects a vibrant domestic economy. Rising government infrastructure and business spending together with steady consumer spending growth have driven economic growth of 6.5% in 2015 and 2016 and 6.7% in 2017. We expect these drivers of growth to keep the economy growing by 6.7% this year and keep imports strong. The shortfall of remittances against the wider trade deficit in 2018 could worsen to between \$1bn and \$2bn. This imbalance would likely keep PHP on the defensive unless foreign direct investments rise as they did in 4Q 2017.

India – A mixed inflation bag

With the risk of worsening public finances overshadowing green shoots of economic recovery, the Indian rupee will remain under weakening pressure in 2018



Source: Shutterstock

5.2% Inflation in December

Worse than expected

Lower WPI but higher CPI inflation in December

Contrary to the consensus of acceleration, India's wholesale price inflation slowed in December to 3.6% year-on-year from 3.9% in the previous month. The consensus was 4.0% while at ING, we were forecasting: 3.9%.

This follows consumer price inflation data last Friday showing acceleration to a 17-month high of 5.2% in December from 4.9% in November. Food prices were a source of divergence in two price measures, while fuel and utility prices remained elevated in both measures. This puts October-

December average CPI inflation at 4.6% and WPI inflation at 3.7%, up from 3.0% and 2.7% respectively from the previous quarter.

Potential inflation risk

The Reserve Bank of India targets CPI inflation for monetary policy purpose, and the medium-term target is set at 2-6%.

However, with 5.2% latest print CPI inflation has already surpassed the RBI's 4.3-4.7% forecast range for the second half of the fiscal year 2017-18. While we do not see inflation breaching the medium-term policy target as yet, the continued upward grind in food and fuel price, and potential overshoot of the government budget deficit keep such risk alive.

8.4%

 Industrial production growth in November

Better than expected

Some green shoots of economic recovery

On some positive news on growth, industrial production surged by 8.4% YoY in November, an 18-month high, on the back of a 30% surge in exports in that month. December trade data will show if the export strength was sustained through the end of 2017. But for now, firmer activity growth supports our forecast of a pick-up in GDP growth to 6.5% YoY in the October-December quarter from the previous quarter of the last year.

On-hold RBI policy in 2018

We don't think the RBI will get carried away by the latest CPI and Industrial Production data for increased tightening at the next monetary policy meeting on February 7. Nor do we expect any change to the current neutral policy stance through the rest of 2018.

Weakening pressure on the Rupee

All eyes are now on the government budget for the fiscal year 2018-19 to be unveiled on February 1, which will be a balancing act for the Modi administration ahead of general elections in 2019.

With the risk of worsening public finances overshadowing green shoots of economic recovery from dual shocks of de-monetisation and poorly planned tax reforms, we expect the Indian rupee to remain under weakening pressure in 2018. Our USD/INR forecast for end-2018 is 64.50 (spot 63.62).

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